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INVESTMENT STRATEGY OUTLOOK - SMALL CAP EQUITY

Quarter Ended December 31, 2005

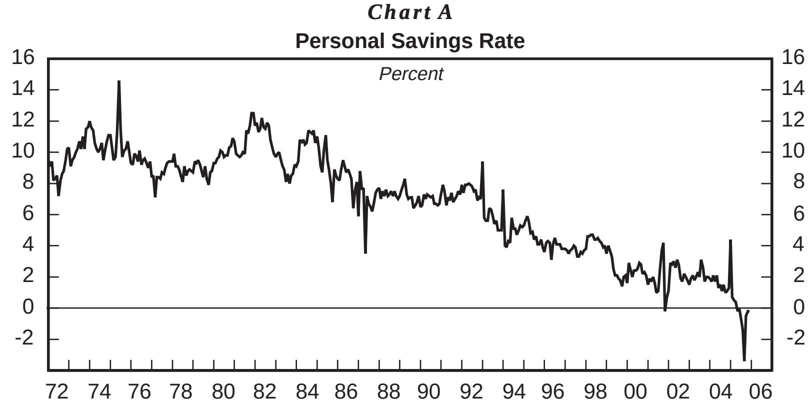
The FMI small cap portfolios gained approximately 10% in calendar 2005 compared to 4.6% for the benchmark Russell 2000. Given several significant negative developments during the year, such as a $70 per barrel oil price, unprecedented hurricane damage, inflation, and an inverted year-end yield curve, we were pleased with the results. Of course, around here we often cringe at making too much of the 12-month period that constitutes the calendar year. It is no more important or meaningful than any other 12-month period and we prefer to measure our investments, and ourselves, over longer-term time horizons. That said, 2005 was a fairly typical year from the standpoint that most of the performance came from relatively few stocks. The big winners in 2005 included three takeovers: Accredo, Renal Care and York International. Four other standouts that were sold during the year are Michael's Stores, Darden, Newfield and Casey's. We continue to own a number of winners, including Arrow, Imation, and St. Mary's.

While how we achieved the results was typical, the actual return for the year was anything but. The long-term average total return (including dividends) for equities has historically been approximately 10%. Ibbotson, who studied stock market returns going back to1926, first verified this return. Ten percent is also a rough approximation for the return of the Standard & Poor's 500 (S&P) since its inception in 1955. It is interesting to note that even generously calling a yearly return within two points on either side of 10% (8-12%) an "average" year, the S&P 500 has only achieved this statistical return four times in its 51-year history. Incidentally, the S&P 500 was up approximately 5% in 2005 — another nonaverage performance! As hard as it is to believe, since 1980, when Fiduciary Management was founded, the Russell 2000 has never had an annual return between 8-12%. We also find it remarkable that the average 10% return of the FMI small cap portfolios in 2005 represents the first time in 26 years that we have had an "average" year. The takeaway message is that stock returns over any 12-month period are unlikely to match the long-term average and are, in fact, very volatile. Achieving average or above-average results requires a commitment to a multiyear investment time horizon.

As is our custom in January letters, we will make some comments on the economy, market and other macro issues.

The Economy

Chart A



Sources: Bureau of Economic Analysis

The current economic expansion is four years old and approaching the post-World War II average of 57 months. Real (inflation adjusted) Gross Domestic Product (GDP) growth in 2005 was approximately 3.7%, although the "final" number will undoubtedly be revised several times in coming quarters. Many economists have stated that this expansion, at least so far, appears tepid by historical comparison. The data, as compiled by The Leuthold Group, supports this conclusion by showing that the post-WWII average real GDP cumulative growth of previous expansions is 25%, while the current rate is 14%.

If the final numbers for this expansion prove to be below average, it will be especially noteworthy because the economy has received a remarkable boost from a variety of factors, including record equity cash-outs from mortgage refinancings, record low savings rates (see Chart A), low long term interest rates, record high government spending, and until recently, low inflation rates. Factors that have depressed economic growth in an unusual way include below-average capital expenditures and sizeable government outlays on wars and security, which lack the typical economic multiplier effect.

The outlook for economic growth in 2006 and beyond depends on a number of factors. Will U.S. corporations, which appear to be cash-rich, increase capital spending? Will the consumer be a source of incremental growth? Will government spending increase? In answering the first question, we look to our own observations as well as recent commentary from Stephen Roach, Morgan Stanley's noted economist. Roach points out that Chinese capital spending (in dollars) is rapidly approaching the U.S. and European levels. This is astonishing, considering that China's economy is less than one-quarter the size of that of the United States. Many of the companies we follow are definitely spending more money overseas, particularly in the Far East. A dollar of capital spent in China, for example, buys perhaps three to four times as much infrastructure as it does in the U.S. Anecdotally, in a conversation we had with the CEO of a multinational manufacturer recently, he stated, "I don't think we'll ever build another plant in America or hire another U.S. based manufacturing employee." Of course, his comments hardly reflect the mainstream, but directionally, the focus is certainly moving East. U.S.-based capital spending seems to be geared more to technology, health care and recreation, but so far this has not been enough to drive significant growth in the overall capital expenditure numbers. Furthermore, we see corporations devoting an increasing share of their cash to fund pension and other post-retirement obligations.

A number of factors contribute to whether or not the consumer can be a source of incremental growth. There is simply no denying the fact that consumer spending has received an enormous push from home equity cash-outs. Our June 2005 letter outlined these figures. Growing home equity lines of credit have also been a source of funds for consumers in recent years, although the rate of growth has slowed from nearly 40% at the start of 2005 to roughly 5% at year-end. We think that a more somber housing backdrop will take some of the wind out of consumption which, incidentally, recently hit 71% of GDP, far above its post-WWII average of 66%.

Wages have lagged during this recovery, but recently there are signs of improvement here. Real wages were up 1% in the latest period. Overall the unemployment rate is only 5%, and the denominator —those actively looking for work — is still depressed; thus, there is latent capacity that could aid future economic growth.

The federal budget deficit was reported at $319 billion for fiscal 2005. While this is an extraordinary number, it was actually down $93 billion from 2004. Interestingly, government receipts were actually up 14.6% from the previous year, proving the spending increase to be quite remarkable. Given the political climate today and the escalating unfunded mandates, it is unlikely that discretionary government spending will be a source of economic growth.

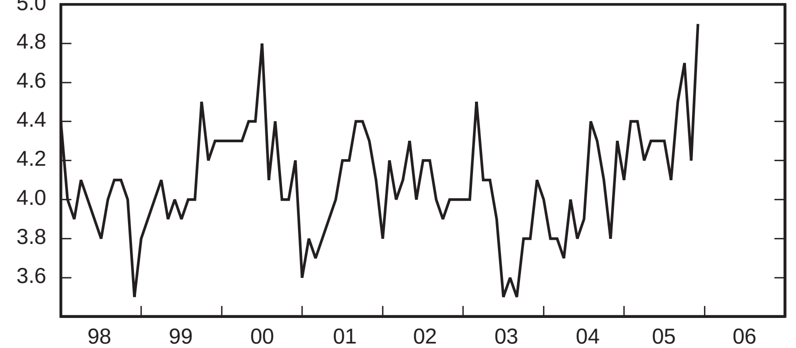
In summary, we don't see a good case for sustaining GDP growth near a 4% rate.

Housing

In previous letters, we have articulated our concerns about the overheated housing market. Merrill Lynch recently indicated that the stock of housing has increased at over a two million per year rate for six months straight. This only happened three times before: 1971-73, 1977-78, and 1984. However, they point out that household formation averaged 2.5% growth during these

Chart B

New Home Sales - Months Supply



Source: Bureau of the Census

periods compared to 1% now. Looking at other periods when household formation was near 1%, Merrill's research shows that housing starts averaged 1.5 million units. Quoting from Merrill's *The Year Ahead* report dated December 6, 2005:

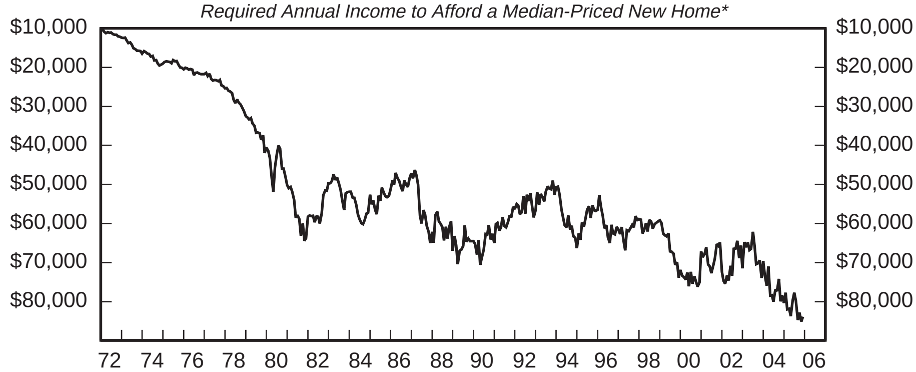
Many speculative periods end when inventories uncontrollably rise, and that may be commencing in the housing market. The backlog of unsold homes has risen to a nine-year high, and the number of unsold newly built single-family homes is up 20% from a year ago. This oversupply of housing seems to be coinciding with factors contributing to the slowdown in housing demand. Affordability for the first-time homebuyer has deteriorated to levels not seen since the tail end of the housing boom of the late 1980s. Today, the lack of affordability is being fueled by higher home prices, as opposed to past periods when the lack of affordability was generally determined by high interest rates.

Recently we have been seeing anecdotal data suggesting that the market has finally begun to soften. Applications for purchase mortgages in late December had declined to the June 2002 level. Mortgage lenders are beginning to retrench, as evidenced by several lenders closing loan-processing centers.

Chart C

Housing Affordability

*Required Annual Income to Afford a Median-Priced New Home**



**Calculation assumes a conventional mortgage and principal and interest payments equal 20% of annual income.*

Sources: Bureau of the Census; Federal Reserve Board

On the cocktail circuit this holiday season, there was still a lot of optimism about housing prices. The data shows housing prices still on the rise, but with inventory up and affordability at low levels, we would bet on a slowdown ahead.

Interest Rates

The yield curve continued to flatten in the December quarter and by year-end was slightly inverted, with the 2-year Treasury Note at 4.40% and the 10-year at 4.39%. Many economists and bond market cognoscenti believe an inverted yield curve preordains recession. According to the Wall Street Journal, over the past fifty years, an inverted yield curve has only given two false signals. That is a remarkable historical artifact, yet many of the pundits believe that because long-dated interest rates are still low, the inversion is unlikely to result in significant economic weakness this time.

While long rates remain relatively low, short rates have escalated considerably. The Fed Funds rate, which was 1% as recently as June of 2004, is now 4.25% and is expected to go modestly higher. The minutes from the Federal Reserve meeting of December 13 suggest the tightening steps may be just about over. The prime rate is now 7.25% with many borrowers looking at 50-75 basis points above this. Money costs approaching 8% start to get one's attention, particularly compared to less than 5% just eighteen months ago. More importantly, the carry trade, which we have discussed several times over the past few years, has basically come to a halt. Recall that a steep yield curve invites speculators to borrow short-term and lend long-term. This has been a key feature in the private equity, hedge fund, derivative, and mortgage finance world in recent times. How all of this plays out remains to be seen, but rest assured, it will not be like the last few years.

Energy

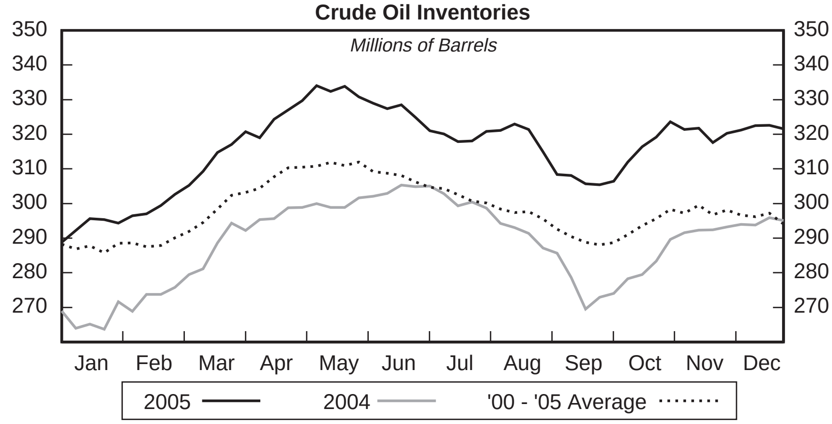
Oil prices have remained elevated, in spite of relatively high inventories. Though wars, hurricanes, terrorist acts, state appropriations in Venezuela and Russia, and other disruptions have conspired against the oil markets, inventories remain healthy. As you can see from Chart D, 2005 crude inventories are well above seasonal averages.

Natural gas inventories are also within their five-year range despite the disruptions from hurricanes.

The current price of crude ($62.94 on January 3, 2006) is up over 50% in the last twelve months and over 100% from 24 months ago. Natural gas has experienced increases of a similar magnitude.

Chart D

Crude Oil Inventories



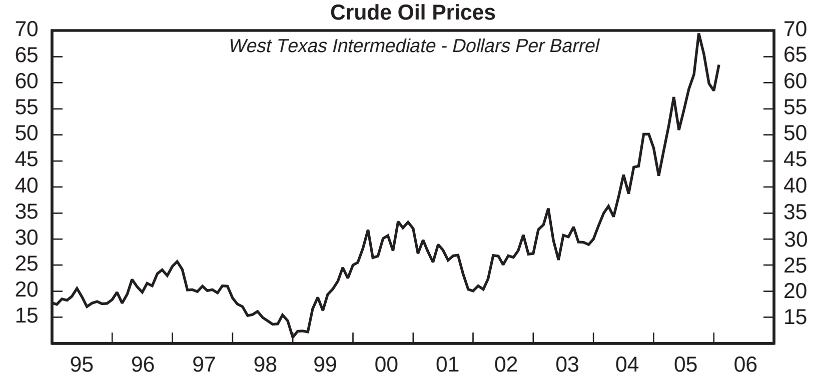
Source: Energy Information Administration

There has been a great deal written about the maturation in oil productive capacity, Chinese and other developing countries' demand growth, and an impending shortage of hydrocarbons. The energy bulls see the current infrastructure straining to boost production, while at the same time projecting a continuation of unprecedented demand growth, and conclude, not surprisingly, that we are poised for "permanent" high prices. Today's energy price scenario is partly a function of investment that took place five years ago. It takes about that long to bring productive capacity on stream. In Chart E, West Texas Intermediate (WTI) is graphed going back to 1995. From 1995-1999 WTI averaged $19.37 per barrel. You can imagine how difficult it must have been to make multi-hundred-million to billon-dollar investment decisions in that environment.

Beginning in 2002 oil prices began to rally. By the end of that year they were over $30 and have averaged $43.23 over the past three years, including an amazing $57.26 last year. We remain steadfast in our belief that price sends a signal to the market, and the response in this case is that of far greater expenditures to find and develop energy reserves. High prices make formerly uneconomic reserves viable. For example, *Oil & Gas Journal* estimates that the oil sands in Alberta alone have 174.5 billion barrels of recoverable reserves. This compares to Saudi Arabia's estimated reserves of 264 billion barrels. Of course, the Canadian oil sands are economic at $40 per barrel, but probably not at $30 per barrel, and it will be many years before a meaningful amount of this oil hits the market. The point is, high prices have already put the mechanism in place that will ultimately deliver lower prices. Moreover, high prices spur conservation. We remember policy makers being perpetually surprised at how energy-efficient the U.S. became after the last big oil shock in 1979. We envision a similar scenario this time around.

Chart E

Crude Oil Prices



Source: Dow Jones & Company

Fundamentally-it is true that it will be a few years before a significant increase in capacity is in place, but in our humble opinion, the price of energy is far in excess of where it should be. Sometime in the next year or two we expect a significant drop in oil and gas prices, a positive factor in what otherwise could be a choppier period for consumer spending.

Inflation

The headline Consumer Price Index (CPI) inflation indicator hit a 14-year high of 4.7% in September of 2005. For the year, the preliminary CPI figure is estimated to have been 3.6%, reflecting a steady increase from the 1.5% level reached in 2003. The Commodity Research Bureau index recently hit a record high of 333 compared to 190 as recently as the beginning of 2002. Energy, being one of the commodities, clearly influences this number, but most commodities are at multi-decade highs. Gold recently hit $533 per ounce, the highest level in over twenty years.

Despite these worrisome statistics that, surprisingly, haven't meaningfully hurt the stock market as yet, we continue to believe that the long-term inflation picture is sanguine. Worldwide inflation is down dramatically from the early 1990s as globalization and technology enable low-cost countries to "export" lower prices around the globe. The wage disintermediation impact from India and China will be a long-running phenomenon, which should keep a lid on U.S. wage growth (and inflation) for the foreseeable future.

Valuation and Market Outlook

Our view of the market is almost always joined at the hip with valuation. As long as the market remains expensive — and it is, when measured by historical valuation benchmarks — we are likely to be less than ebullient about its prospects. Based upon statistics for the S&P 500 (reliable long term data is not available for small cap benchmarks), and courtesy of The Leuthold Group, the current valuation falls somewhere between the seventh and ninth decile (tenth being the most expensive) depending on which measure is used. The price-to-cash flow multiple is in the seventh decile, the price-to-sales and price-to-book ratio fall in the ninth decile, and the price-to-earnings ratio (normalized) is in the eighth decile. The dividend yield is in the ninth decile. This data spans approximately fifty years and nearly every kind of economic environment and stock market.

The FMI portfolios, as articulated in our last letter, trade at much more reasonable valuations, but are still slightly above long-term averages.

At the beginning of this letter we noted that our approximately 10% gain in 2005 fell roughly on the statistical average for common stocks over the long-term, yet marveled at the rarity of achieving average performance in any one year. Yearly returns tend to be high or low. Valuations are somewhat analogous to this, but they play out over longer periods. A view of valuation histograms would quickly reveal that they are not smooth bell curves. They tend to be more "barbell" in nature, aggregating away from the average. In a future letter we will discuss this in more detail. Suffice it to say that the right side of these barbells is dominated by valuations from the 1995-2005 vintage. We are neither expecting, nor building a portfolio that depends upon a continuation of historically high valuations. We like to think of our stocks as all-weather vehicles but we recognize that at some point in the future — and it could be years away — this market will transition from high to low. The duration of such a transition would determine how painful it would be. Certainly, even our durable franchises would be impacted, but we feel that the valuation advantage in our holdings would serve us well in more difficult market environments. One of our favorite phrases around here is "plan for tough times and hope for good times."

Thank you for your support of Fiduciary Management, Inc.

Fiduciary Management Inc.
Small Cap Equity Composite
12/31/2000 - 09/30/2011

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
2001	20.42	19.57	2.49	125	1.88	$ 587.2	$ 1,458.2	40.27%
2002	-4.78	-5.46	-20.48	154	1.47	$ 649.7	$ 1,731.0	37.53%
2003	27.18	26.22	47.25	167	1.93	$ 1,206.9	$ 2,927.0	41.23%
2004	20.92	20.02	18.33	181	1.00	$ 1,486.6	$ 3,085.8	48.18%
2005	11.12	10.26	4.55	186	0.69	$ 1,605.8	$ 3,174.4	50.59%
2006	18.46	17.56	18.37	147	0.73	$ 1,606.8	$ 3,589.4	44.77%
2007	-0.92	-1.72	-1.57	161	0.85	$ 1,520.2	$ 3,960.4	38.39%
2008	-21.06	-21.69	-33.79	145	1.16	$ 1,212.4	$ 4,062.5	29.84%
2009	35.72	34.56	27.17	165	0.97	$ 2,004.6	$ 7,008.9	28.60%
2010	23.45	22.43	26.85	170	0.48	$ 2,477.7	$ 9,816.0	25.24%
Q1 2011	7.18	6.96	7.94	182	0.19	$ 2,699.2	$ 11,338.0	23.81%
Q2 2011	1.16	0.96	-1.61	179	0.11	$ 2,718.9	$ 11,819.6	23.00%
Q3 2011	-16.12	-16.29	-21.87	178	0.31	$ 2,188.9	$ 10,357.9	21.13%

*Benchmark: Russell 2000 Index®

Effective January 2012, 2004 – 2011 gross and net composite returns and dispersion were restated due to an error.
Returns reflect the reinvestment of dividends and other earnings.
The above table reflects past performance. Past performance does not guarantee future results. A client's investment return may be lower or higher than the performance shown above. Clients may suffer an investment loss.

Fiduciary Management, Inc. (FMI) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. FMI has been independently verified for the periods 12/31/1993 - 09/30/2011. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Small Cap Equity composite has been examined for the periods 12/31/1993 - 09/30/2011. The verification and performance examination reports are available upon request.

FMI was founded in 1980 and is an independent investment counseling firm registered with the SEC and the State of Wisconsin. The firm manages over $10.3 billion in assets of pension and profit sharing trusts, mutual funds, Taft-Hartley funds, insurance company portfolios, endowments and personal trusts. The firm includes both institutional and mutual fund business. Although the firm has participated in wrap programs, it is a separate and distinct business, and is excluded from firm-wide assets.

The FMI Small Cap Equity Composite was created in January 1980. These accounts primarily invest in small to medium capitalization US equities.

The FMI Small Cap Equity Composite reflects time-weighted and asset-weighted returns for all discretionary accounts, with a market value greater than $500,000 as of month end. A small percentage of composite assets (typically ranging from 0-5%) historically has been invested in unmanaged fixed income securities at the direction of account holders. From December 31, 1993 thru September 30, 2002 all accounts included were managed for at least one quarter, from October 1, 2002 to present all accounts were managed for at least one month. All returns are calculated using United States Dollars and are based on monthly valuations using trade date accounting. All accounts in this composite are fee paying. Gross of fees returns are calculated gross of management fees, gross of custodial fees, gross of withholding taxes and net of transaction costs. Net of fees returns are calculated net of actual management fees and transaction costs and gross of custodial fees and withholding taxes. Dispersion is calculated using the standard deviation of all accounts in the composite for the entire period.

Currently, the advisory fee structure for the FMI Small Cap Equity Composite portfolios is as follows:

Up to $25,000,000	0.90%
$25,000,001-$50,000,000	0.85%
$50,000,001-$100,000,000	0.75%
$100,000,001 and above	0.65%

The firm generally requires a minimum of $3 million in assets to establish a discretionary account. High Net Worth individuals may establish an account with a minimum of $1,000,000, however, the firm reserves the right to charge a minimum dollar fee for High Net Worth individuals depending on the client servicing involved. The minimum account sizes do not apply to new accounts for which there is a corporate, family, or other substantial relationship to existing accounts. In addition, the firm reserves the right to waive the minimum account size and minimum annual fee under certain circumstances. A complete list and description of all firm composites is available upon request.
Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The Russell 2000 Index® measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 8% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Small Cap Equity composite uses the Russell 2000 Index® as its primary index comparison.